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Prince Henry Navigator II Investor

Via email:

Dear Fellow Investor:

Investor Day Thursday, February 28th in New York

Of the ten outside managers who have or soon will have Navigator's capital, nine have confirmed their plans to attend Navigator's Investor Day. With this 90% response rate, I cannot emphasize enough that no letter can communicate the information as well as the presentations and the question and answer sessions in New York.

I thank all of you who have already told me you plan to attend for your enthusiastic response. To anyone not planning on coming, if Navigator represents a meaningful investment for you, I strongly encourage you to make time to attend. Planning and executing Investor Day requires a significant investment of time and money. It is not something that I can do often. I am going to do everything I can to make it a worthwhile and enjoyable experience for investors, but that will not matter if you are not there.

I apologize to those of you who have experienced trouble with Marriott. Marriott has fixed those problems and has extended our deadline for hotel registration until 5:00 P.M. on Friday, January 4th. If you need help with logistics, please contact me.

Introduction

Thanks to all of you who have read my previous letters and emails and who have responded with comments, questions, and constructive criticism. Thanks also to those of you who have told me that you were snoring by page three. Especially for this latter group, I introduce these Navigator Snapshot and Executive Summary sections.

Navigator II Snapshot

	Investment	% of Portfolio	Presenting at Investor Day
1.	Pabrai	9.90%	TBD
2.	Point Clear	2.23%	Yes
3.	TriPro Pool II	12.28%	Yes
4.	Sellers	7.33%	Yes
5.	Semper VIC	11.00%	Yes
6.	T2 Partners	7.33%	Yes
7.	Berkshire Hathaway	17.23%	NA
8.	Delta Financial	2.57%	NA
9.	Contango	2.57%	NA
10.	Hawkshaw Partners	7.33%	Yes
11.	First Premier Corp.	3.67%	Yes
12.	Cash	16.57%	N/A
13.	Greenlea Lane	0.00%	Yes
14.	Eastwood	0.00%	Yes
	Total	**100.00%**	

Note: All of these percentages reflect Navigator's cost.

Executive Summary

As I have said to you in my recent update calls, I have never felt more comfortable with Navigator's investments. I come away from a series of meetings and calls with the managers to whom Navigator has entrusted capital feeling good about current performance and, much more importantly, convinced that all of Navigator's funds are well positioned for a variety of market environments. I remind you that a common thread among all Navigator's partners is that the people Navigator's capital is backing all have the overwhelming majority of their net worth invested in their own vehicles. Their investment, like my own in Navigator, creates a natural alignment of interests with their investors. While all of these managers want to compound capital at a high rate so as to earn the incentives due them for that achievement, they are all first focused on preserving the capital.

Lest this previous paragraph smack of arrogance or hubris, or both, I hasten to add that Navigator will have negative periods. A second common thread of Navigator's managers is that they mostly believe that the public investment markets tend to be highly efficient in the short term. Hence, none of them would accept investor money with the intention of outperforming the broad stock market indices every day, week, month, quarter, or year. Even though I have made this point in previous letters, I cannot emphasize it enough, as patience is one of Navigator's greatest competitive advantages. Recent research from James Montier at SG Cowen Research indicates that out of a universe of 100 outperforming fund managers, 70% of them underperformed three years in a row. In his new book Behavioural Investing, James concludes "We need to extend time horizons. That means being honest with clients about the risk for underperformance, and admitting limited skill when it comes to picking investments for the short term. Of course, this will come as anathema to most investors."

For anyone not planning to read beyond this section, I thank you for your extremely positive response to attending Navigator's Investment Day on February 28th. For those of you not to planning to attend, I reemphasize that this day offers your single best opportunity to understand Navigator for the life of the fund, and I urge you to prioritize attending.

Bad News

Through a series of bad decisions, I managed to lose 2.57% of Navigator's money through an investment in Delta Financial Corporation. I apologize for this error.

In terms of Navigator's performance to date, I cannot give you an exact number because we will only know the value of our private investments, such as TriPro and Premier Bank, when we sell them three to five years from now. However, even with this 2.57% loss in Delta Financial, Navigator's overall portfolio is up very significantly.

I make this point about Navigator's overall performance not to mitigate my frustration with the Delta Financial loss but rather to place it in the context of the overall portfolio. Navigator will have other losing bets like Delta: places where the reward to risk is extraordinarily attractive but still the investment does not succeed. If we do not have some of these, I am not doing my job. With Delta, for example, I thought that we had a chance to make on the order of 7X (or 700%) our investment if Delta worked, and had some chance of losing 100% in a very negative scenario.

As much as I would like to sweep Delta under the rug and forget about it, a productive post mortem has value for your understanding of how Navigator is managed and for Navigator's future performance. This mistake will not be my last one, but I do hope to learn from it so as not to replicate this same error in the future. For this reason, I will describe the investment process and what I think I did wrong with the Delta investment.

Delta Post Mortem

In every investment I try hard to focus on one big key. Warren Buffett has famously said that if you only have to get one thing right and have an 80% probability of being right on that factor, then you have an 80% probability of being right with the investment. If two 80% probable things both have to happen, then the probability of having success with the investment falls to 64% (80% * 80%). If three 80% probable things have to happen, the probability of success falls to 51.20% (80% * 80% * 80%) and so forth.

In this investment, Delta Financial Corporation, I was focused on whether Delta's customers, sub prime mortgage borrowers, could repay their loans. I believed that they could, based on three metrics:

1. About 90% of Delta's loans were fixed rate, so their borrowers would not have their payments increase in a rising interest rate environment. The teaser loans that so many banks have been unable to collect after the teaser period ended did not apply to Delta.
2. Delta had a loan to value ratio of about 80%, meaning that if a house was worth $100 Delta would only loan $80 against it. Hence, the house value would have to fall 20% before Delta starting taking losses.

3. Finally, unlike most sub prime lenders, Delta made over half of the loans themselves. Delta was not buying pieces of paper that they did not understand which had been underwritten by other firms. Delta was underwriting loans that were carefully screened by their own employees.

Navigator's best idea investments or best ideas, which typically comprise less than 10% of Navigator's total capital, but have an opportunity to generate much more than 10% of its returns, generally come from one of two sources and screens:

1. The funds in which Navigator invests
2. Navigator's own investors via their industry specific expertise

Delta went through both screens. Mohnish Pabrai, manager of Navigator investment Pabrai Fund IV, does not discuss portfolio holdings, but he presented the Delta idea as an investment to a conference that benefits a charity. In addition to seeing Mohnish's presentation on Delta, I did a great deal of homework with Navigator investors: two in particular who have over 50 years of experience as financial sector executives. They were very comfortable that Delta's customers could pay.

Sadly, both Mohnish and our investors were right: Delta's customers could pay. However, this fact did not matter because the company had made long-term loans to others while borrowing short term. When Delta could not renew its short term borrowing, it tried to sell off its loans but could not sell off enough to meet its obligations. Hence, I focused on one question so much that another critical question did not occur to me. I was like that man looking up and wondering about rain who gets swept away by the overflowing river coming straight at him. I oversimplified and did not understand how an inability to borrow could make Delta unable to pay.

Lessons Learned

Delta is my fault, and I want to make certain that this letter does not imply anything to the contrary. Mohnish Pabrai has made clear to every single investor in his funds that he does not discuss Pabrai Funds' investments with anyone. For our best idea model to work, however, an open exchange of information with the idea generator, in this case Mohnish, is vital. Hence, I am very happy that Navigator is invested in Pabrai Fund IV, but I am extremely unlikely to initiate any other best idea investments from Mohnish.

The two other Navigator best ideas, discussed later and sourced by Sellers Capital and T2 Qualified Fund, are up about 33% and 30%, respectively, since Navigator invested in them. Moreover, Navigator has looked at a series of potential best idea opportunities identified by the funds in which Navigator invests. Specifically, I monitor these funds' largest investments and the fund managers' rationale for making them. Next, I consult with Navigator investors who have special knowledge in that sector or industry. Then I decide whether or not Navigator has a particular edge to make this investment and whether the investment offers an asymmetric profile of reward to the risk of permanent capital loss. I have declined most "best idea" investments that we have screened, and some of Navigator's investors and I have persuaded some of our funds to abandon or to modify their investment theses with regard to individual companies.

Individual Investment Review

I am going to go through what I think are the salient details of each investment. In addition, where I have a recent detailed report from the manager, I will include that as an attachment in my email to you.

1. **Pabrai Fund IV:**
   I cannot add a great deal to Mohnish Pabrai's comprehensive 3rd quarter letter which is attached. For the first three quarters of 2007, Pabrai Fund IV was up 6.9%, net of fees. Given the fall in the shares of Delta Financial which I described in detail above, I expect Pabrai Fund IV to fall some in the 4th quarter of 2007 but do not know by how much. There are two factors that matter most to me with regard to this fund:
   a. As Pabrai's attached letter states, over a seven year period, a very reasonable time frame over which to make an assessment, his Pabrai Fund II has compounded at an annualized rate of 26.5% net of all fees vs. 6.5% for the best index.
   b. In conversations with Mohnish Pabrai at his investor meeting in California in September and at the Value Investing Congress in November in New York, he emphasized two points:
      i. He has never felt better about the discount of the Pabrai Funds to their intrinsic value. In other words, he has never felt better about the safety of principal and the potential for upside in the companies that the Pabrai funds hold than he does right now.
      ii. The best time to buy Pabrai Funds has been when the short-term performance was the worst.

   I remain comfortable with this investment and look forward to continued outperformance over time.

2. **Point Clear Capital Hedge:**
   As of Monday, December 24th, this hedge was up 49.58%. At various times during the year I have sold parts of the hedge and redeployed them in other investments. This hedge has provided a powerful compliment to Navigator's portfolio given the credit crisis that has started in 2007.

3. **TriPro Pool II:**
   TriPro's attached letter provides a comprehensive review of Navigator's investment in TriPro. This investment is, in general, one of the least understood by Navigator's investor base. TriPro's lead principal, Eric Conner, is preparing what I believe will be a very compelling overview of TriPro's history and, most importantly, its current and future opportunities for Navigator's Investor Day in New York.

4. **Sellers Capital Fund:**
   As of the end of November, Seller's Capital was up roughly 35% for the year net of all fees. Mark Sellers' third quarter letter is attached, but I include one salient statistic for you. The fund was down 17% in the third quarter and then made it all back in the first five days of the fourth quarter. This fund, like the Pabrai Funds and most of Navigator's Funds, is extremely concentrated. It is going to be volatile -- i.e. it is going to have great periods and lousy periods. Mark Sellers views volatility as a friend and so do I. As I have tried to say ad nauseam, I am not focused on getting consistent returns, only on getting outstanding returns over time. To again cite Warren Buffett's quote "We would rather have a lumpy 20% return than a smooth 12%."

   Some of you have inquired what makes Navigator different from a Fund of Funds: investments in concentrated funds like Sellers is one of the ways Navigator differs from a Fund of Funds. Very few

Funds of Funds would invest in a fund like Sellers because the manager could get fired because the fund lost 17% in the third quarter. With your consent, I have structured Navigator so that, assuming I act in an ethical manner, it is very difficult to fire me. Moreover, I not only have $250,000 at risk but have volunteered to take the first $100,000 of losses. No one is more focused than I am on not losing capital on a permanent basis. I do not, however, have any interest in drawing meaningless conclusions by extrapolating the score from the second inning to the end of the game.

After a year of regular interaction with Mark Sellers and his team, I am extremely impressed by their

a. Disciplined focus on out of favor companies which have either little to no premium to the breakup value of the company or a wide economic moat to protect against competitors.
b. Rigorous research process often analyzing companies that no Wall Street analysts follow.
c. Thoughtful and creative process of sizing individual portfolio bets using the Kelly Formula

For all of these reasons, I have decided to increase Navigator's investment in Seller's Capital. As of January 2, 2008 Navigator's investment in Seller's will increase from 7.33% to 11% of Navigator's portfolio.

5. **Semper Vic Partners Fund:**

Semper Vic is up 6.23% net of fees through the end of November. Tom Russo, the fund's manager, has compiled compounded net returns of about 17% per year since 1984. Mr. Russo says that the question investors most often ask him is "Don't you read the newspapers?", meaning that he is frequently buying companies that are distressed and out of favor. In the short term, these companies do very poorly, but in the long-term Mr. Russo's funds have performed extremely well. In addition, Semper Vic holds a number of companies outside of the U.S., giving Navigator some helpful exposure to non dollar denominated assets.

After a recent meeting with Mr. Russo and his team, I am more comfortable than ever that Semper Vic will constitute a safe vessel no matter what the medium to long-term economic and market conditions. For these reasons, as of January 2, 2008 I am increasing Navigator's investment in Semper Vic from 11% of Navigator's portfolio to about 18% of Navigator's portfolio.

6. **T2 Fund:**

T2 is down net 0.5% for the year through November 30th. T2's November letter is attached as well, but the letter's first paragraph merits including verbatim:

> "The combination of a concentrated portfolio and volatile markets is causing our fund's returns to bounce around a bit more than usual: after surging 8.2% in October, it fell 4.5% last month (vs. declines of 4.2%, 3.8%, and 6.9% for the S&P 500, Dow, and NASDAQ, respectively) and in the first three trading days of December, it's up 3% (hopefully a good omen for the rest of the year!) Such volatility in our portfolio does not trouble us – we have never sought smooth returns – and, in fact, when it's driven by market volatility, we embrace it, as the best bargains are typically found when investors are panicky."

T2 also deserves tremendous credit for Navigator's investment in Berkshire Hathaway. I have followed and owned Berkshire for years but understand the company and its valuation much better as a result of the outstanding work done by the T2 team.

7. **Berkshire Hathaway:**
Berkshire falls into two categories
   a. A "best idea" owned by a number of the funds in which Navigator invests including Pabrai, T2, and Semper Vic.
   b. A placeholder, or an extremely safe vehicle in which to hold cash with the opportunity to earn better than bank interest while waiting to make other investments.
   As I mentioned in the T2 section above, the best presentation I have seen on Berkshire is by Whitney Tilson and Glenn Tongue of the T2 Fund. Glenn will present it at Navigator's Investor Day. For any of you with particular interest, I am happy to share it with you in advance. The bottom line is that they view Berkshire's fair value as about $6,000 for the B shares and $180,000 for the A shares. This value does not assume a negative market environment. In a lousy market environment where Berkshire with roughly $40BN in cash, has an opportunity to buy investments "on sale" while others are panicking, Berkshire is likely to appreciate significantly more. In addition, Berkshire's value increases each year, as its component business continue to generate more and more cash.

8. **Delta Financial:**
One point I did not cover in the "Bad News" section was my reaction when Delta deteriorated. I did not just say "Oh well" and write it off. Instead, I used my decade of experience in investing in private companies and contacted the company and their investment bankers about organizing a group of funds to make an investment in Delta. These discussions led me to conclude that Angelo Gordon, who had invested $50 million in Delta at the same time Mohnish Pabrai had invested $10 million, had the inside track in terms of any new money going into the company. Therefore, I decided not to take possession of any material non-public information which would have prohibited me from selling Navigator's shares or from buying more shares at a distressed price.

When Angelo Gordon and Delta announced that Angelo Gordon had agreed to invest another $100 million, subject to Delta being able to sell $500 million of its loans in the secondary market, I concluded that completing the $500 million sale was the big challenge. If Delta sold these loans and Gordon injected the $100 million, I thought the company would very likely survive. Yet, given that Delta was little known when the company's equity value was north of $400 million, I thought it was very unlikely to be followed by many investors when its equity value was closer to $40 million. In other words, I thought there was a chance for an event to happen that removed much of Delta's risk but thought that Delta's price would not increase by much on the news because Delta was not too small for most investors to pay any attention. Therefore, if Delta sold the loans and got the Gordon money, I was considering doubling Navigator's bet with only an incremental investment of about 20% or about $15,000. Hence, we would now have had about 3% of Navigator's capital invested in Delta, instead of 2.57%, but we would now own twice as many shares of Delta with our average cost per share having fallen by 40% because we bought half the shares at a distressed price of around $2 per share. I thought the company could be worth only about 1/3 as much as my original valuation target, ($12 per share instead of $35 per share) but Navigator would still have had an outstanding chance of doubling its 3% investment due to a 40% reduction in Navigator's average cost per share.

All of this probabilistic analysis was academic, however, as Delta could not sell off the $500 million of loans and Delta filed for bankruptcy.

I do not expect Navigator's Delta shares to be worth much but, at present, do not plan to sell them. The situation is very uncertain and the option value of the shares, particularly given the intense regulator interest in the sub prime mortgage sector, is worth more to me than the pennies on the dollar I can get for our 2.57% stake.

As a final point, I do not know whether the results would have been any better had I had access to Mohnish Pabrai's investment thesis. I do know, however, that my fellow Navigator investors and I who researched Delta would not have had to reconstruct Mohnish's thesis. Instead, we could have spent all of our time looking for evidence that contradicted the thesis. Again, the fault is mine. From now on, though, Navigator's "best ideas" will only come from those willing to openly share their thinking with us in exchange for our own sharing of what we discover with our own homework.

9. Contango:

The direct opposite of Delta -- Mark Sellers and his Sellers Capital team sourced this idea and put 50% of Seller's Capital into it. (This very concept of 50% of a fund into a fund's best idea would give Fund of Funds managers angina.) Mark's thesis was that Contango:

a. Traded at a very small premium to the breakup value of its assets, so there was very little risk of a large permanent capital loss.
b. Was not followed by any Wall Street analysts.
c. Had a number of projects that alone could be worth in excess of the company's current value.
d. Benefited from management that was 100% aligned with shareholders and had an outstanding record of capital allocation.

This position is up 33% since Navigator entered. We will not exit in 2007 for tax efficiency reasons but will probably sell in early 2008 as the investment is within 20% of Mark's price target and we have better opportunities elsewhere.

10. Hawkshaw Partners Fund:

The fund is up 17% net of fees through the end of the third quarter. Hawkshaw's third quarter report is attached, and I encourage you to read it. More recently, I learned that Hawkshaw is still up 17% net of fees through the end of November.

Given Hawkshaw's intense research focus into unknown and often out-of-favor names, I think that at some point Hawkshaw will contribute at least one outstanding best idea investment to Navigator.

11. First Premier Corporation/Charter Bank:

This investment is like TriPro or any other private investment. We are going to find out how we do when we sell it. That said, I have a very high regard for and a great deal of faith in this de novo bank's Chairman, Roy Williams, and its CEO, Greg Cronin. Roy and Greg are coming to Investor Day, and I am very much looking forward to their presentation. Earlier I emphasized the importance of trying to focus on the most critical variable in an investment. In de novo banks, all of the industry experts with whom I consulted before making this investment, including a number of Navigator's own investors, told me that growing deposits is the most important variable. In this regard, I feel so comfortable with Charter bank's management and board of directors that I caution you if you come to Investor Day, you are likely to leave as a depositor of Charter Bank.

12. Cash:

Almost 17% in cash is not a prescient market call on my part. This high cash position occurred because we received some slugs of money late in calendar 2007. Given that funds typically receive money only on the first day of the quarter or month, we have not yet been able to invest the cash.

13. Upcoming Investments:

a. We will be putting about 4% of Navigator with Green Lea Lane Capital. Green Lea is run by Josh Tarasoff, a young manager who focuses on unknown companies typically with market caps below $200 million. Many things impress me about Josh including the fact that he has $1.4 million of his own money invested in the fund. Given his focus on companies that relatively few professional investors examine, he is also very likely to discover one or two best idea candidates that have a chance to provide a ten fold return to Navigator. At present, Josh is already researching one such company in concert with one of Navigator's investors.
b. It is not yet confirmed, but I also expect Navigator to make an initial investment partnering with Jordan Sarick on a duplex property in Aspen. I hope that this investment is the first of many that Navigator will do in concert with Jordan.
c. In addition, we continue discussions on a few new investments and may add to some existing ones as well. I expect to have concrete details to report to you in February.

Thank you again for your investment. As I have tried to say to each of you, I am grateful for the confidence you have shown in me. I will do everything I can to prove worthy or your trust and of your money.

I will call each of you soon to solicit questions and feedback. If, in the interim, you have questions, concerns, or constructive criticisms, please call me at 917-509-2161 or send me an email.

I hope to see all of you on February 28th at Navigator's Investor Day.

Sincerely,

Dan Anglin